United States Court of Appeals

for the Second Circuit

APPELLANT'S PETITION FOR REHEARING EN BANC

76-4162

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

FEDERAL BULK CARRIERS, INC.,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

B
P/S

PETITION FOR REHEARING
AND SUGGESTION FOR
REHEARING IN BANC

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PETITION FOR REHEARING

Petitioner-Appellant Federal Bulk,* petitions for rehearing pursuant to Fed. R. App. P. 40 and suggests rehearing in banc pursuant to Fed. R. App. P. 35, of the portion of the decision and judgment of this Court (Smith & Brieant, JJ.; Feinberg, J., concurring) which held that the losses in question recognized by Federal Bulk in 1965 and 1966 arose from the sale of stock and debentures of Bessbulk.

REASONS FOR GRANTING REHEARING

THE MAJORITY ERRED IN HOLDING THAT THE LOSSES IN QUESTION INCURRED BY FEDERAL BULK AROSE FROM A SALE OF STOCK AND DEBENTURES OF BESSBULK

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* The definitions adopted in Petitioner-Appellant's briefs are used in this Petition.

The majority reached its decision in this case on the basis of a factual assumption that the $423,017.42 in losses recognized by Federal Bulk in 1965 and 1966 arose from the sale of stock and debentures of Bessbulk. There is no basis in the Record, the Tax Court decision, or even in the Commissioner's own briefs, for this Court to indulge in such an assumption.

What was assumed by the parties, and what was assumed by the Tax Court below, was that Federal Bulk's losses arose from the 1961 sale of Tankers stock and debentures and simultaneous undertaking with Maple Leaf to share future operating profits and losses of the Monarch. The issue between the parties, the issue decided by the Tax Court, and the issue appealed to this Court, was whether the losses were ordinary losses arising from Federal Bulk's obligation to share future operating losses, or, under Arrowsmith*, were capital losses relating back to the sale of Tankers stock and debentures. At oral argument, counsel for the Commissioner reiterated that the foregoing were the assumptions and the issue before this Court.

The Record shows that Bessbulk's sole function was to serve as an incorporated pocketbook which would assure Maple Leaf that Federal Bulk would fulfill its financial

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* Arrowsmith v. Commissioner, 344 U.S. 6 (1952).

commitment to share future losses of the Monarch. An ordinary escrow arrangement at a bank might have been used were it not for Maple Leaf's requirement that it have jurisdiction over a Canadian entity. Indeed the Commissioner has urged that Bessbulk be treated as an escrow fund:

> "[Federal Bulk and Bessemer] were required to secure that guaranty by placing $1,900,000 of the money received on the sale [of Tankers] in what amounted to an escrow (the Bessbulk corporation). When the guaranty period ended, on the sale of the Monarch by Maple Leaf, aggregate operating profits were well below what had been projected and guaranteed. Thus, taxpayer was required to give up a net of some $400,000 of its share of the money that had been placed in escrow (Bessbulk). . . ." Commissioner's Brief, p. 12.

* * * *

> "The sale of Bessbulk securities was the culmination of a series of transactions, going back to 1961, which involved, in essence, the sale of the tanker vessel, Monarch. . . ." Commissioner's Brief, p. 17.

* * *

> "This guaranty was secured by the formation of Bessbulk, into which taxpayer and Bessemer put $1,900,000 of the money received for the Tankers stock and notes. Bessbulk then became a party to an indemnity agreement (the 1961 Indemnity Agreement) which was to serve to carry out that guaranty. Bessbulk was prohibited from issuing additional shares, changing the terms of its debentures, or engaging in the active conduct of any business. Its activity was restricted to investment in certain securities. Bessbulk's right to pay dividends, repurchase its shares, or retire its debentures were all restricted. Thus, Bessbulk was essentially an escrow fund." Commissioner's Brief, p. 18 [Citations omitted].

The parties agree that Bessbulk was an escrow fund. When the time arrived for Federal Bulk to settle its obligations with Maple Leaf, the assets of Bessbulk--which were liquid securities--were valued and Federal Bulk was paid its share of the escrow. Maple Leaf received the balance. The mechanism for settling the escrow was a sale of Bessbulk stock and debentures to Maple Leaf; but this "sale" of itself produced no gain or loss. Instead, what produced the loss was the transaction which gave rise to creation of the escrow in the first place--Federal Bulk's commitment made in 1961 to be responsible for a share of the future operating profits and losses of the Monarch.

Whether Federal Bulk sold Bessbulk to Maple Leaf in 1961, 1963 or 1965, or never sold it at all, is completely irrevelant to this case. What is relevant, and what this Court failed to decide because of its indulgence in an erroneous factual assumption, was whether the losses incurred by Federal Bulk were ordinary losses resulting from its agreement with Maple Leaf to share future operating profits and losses of the Monarch.

There should be no doubt that the losses incurred by Federal Bulk were ordinary losses. The only issue the Commissioner might have raised in this case--but he chose not to--is whether those losses should have been reportable year-by-year as incurred, instead of in the aggregate in 1965.

Instead of protecting the fisc, as the Court thinks it has done, if this decision is left standing the fisc will be left unguarded. Turning the facts around, if the Monarch had operated at a profit, by putting its share of the profits in an incorporated escrow account (Bessbulk in this case), this Court will have enabled Federal Bulk to convert ordinary operating profits into a long term capital gain by merely selling stock (a capital asset) of the escrow account. Surely the Court could not have intended such a simplistic result to apply on the profit side, but that is the result if the decision is left standing on the loss side.

The issue upon which this Court decided the case was not argued before the Tax Court, did not enter into the Tax Court's decision, was not argued by either Federal Bulk or the Commissioner before this Court, is not an issue raised by the record before this Court, and is contrary to the understanding of the parties and the Tax Court as to what is the issue raised in this case. Therefore, this Court should grant a rehearing and consider this case as it was presented to it. Alternatively, at a minimum, this Court should remand the case to the Tax Court for a factual determination whether the losses in question arose from the sale of the Bessbulk shares and debentures, or from the 1961 transaction in which Federal Bulk agreed to share future profits and losses of the Monarch.

CONCLUSION

The majority's assumption that the losses in issue arose from the sale of Bessbulk stock and debentures is contrary to the Record, the issue as presented by the parties, and the basis of the decision of the Tax Court below. For this reason, a rehearing should be granted, and the matter should be heard in banc. In the alternative, the case should be remanded to the Tax Court.

August 2, 1977

Respectfully submitted,

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Of Counsel

CERTIFICATE OF SERVICE

It is hereby certified that the service of the Appellant's petition for rehearing has been made of counsel for Respondent-Appellee on this 2nd day of August, 1977 by mailing 4 copies thereof in an envelope with postage prepaid, properly addressed to him as follows:

Daniel F. Ross, Esq.
United States Department of Justice
Washington, D.C. 20530

Att: MCB:GEA:DFRoss:jmg
5-13512

/s/ William F. Indoe
Attorney